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TREASURY FOR YUAN AND TVARDEK

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TAGS: EIND EFIN EAIR ECON EINV PREL CA
SUBJECT: Treasury Discussions with Canada Regarding Export Credits
for Bombardier C-Series Aircraft

SENSITIVE BUT UNCLASSIFIED. PLEASE PROTECT ACCORDINGLY

¶1. (SBU) SUMMARY: On September 2, Treasury DAS for Trade and Investment Sharon Yuan, Treasury Director for Trade Finance Steve Tvardek, Embassy EMIN, Embassy Commercial MC and Senior ECON FSN met with officials from key GOC departments and representatives from Canada's export financing agency to discuss the issue of Canadian export financing in U.S. markets for Bombardier C-Series aircraft. The central USG message, based on interagency talking points, was that export financing for Bombardier's new larger aircraft would almost certainly trigger pressure for matching domestic financing for Boeing aircraft in the U.S. Canada was urged to adopt the Home Market Understanding (HMU) utilized by the U.S. and European Union for more than 25 years, which prohibits the use of export credits into the markets of producers of competing aircraft or "home markets". The Canadian officials seemed to appreciate the opportunity to explore the broad implications of Bombardier's entry into a new market area but their immediate willingness to adopt the Home Market Rule or similar measure seems unlikely. A key potential issue for Canada was their wish to see Brazil and other aircraft-producing nations similarly bound.

Joint Meeting with Finance, DFAIT and PCO

¶2. (SBU) On September 2, Treasury, Embassy EMIN, CMIN and ECON FSN held a joint meeting with GOC officials from the Departments of Finance, Foreign Affairs and International Trade (DFAIT), and the Privy Council Office(PCO). Treasury outlined concerns based on interagency talking points regarding possible export credit to Bombardier C-Series (BCS) aircraft via Export Development Canada (EDC). In particular, if EDC were to support BCS exports to the U.S. market, it would create an uneven playing field because there is no domestic financing available for Boeing. Within the current economic climate, Canadian export credits would create a competitive disadvantage for Boeing in its home market (and similarly for Airbus in the U.S. market as well as in its own home markets). Both U.S. and the European Airbus consortium countries are fully implementing the OECD Aircraft Sector Understanding (ASU) including its "Purpose" section which: "avoids distortion of competition among Participants..." by adhering to the HMU which proscribes export financing into producer or "home" markets for competing aircraft. Treasury urged that Canada, as a new producer of a competing aircraft, adopt the HMU as well.

¶3. (SBU) Of secondary importance is the issue of classification for BCS - Category 1 or Category 2 - to be discussed again at the ASU

technical meeting in Paris on October 1, 2009. While the U.S. expects to have a final position on classification for the October meeting, Treasury stressed that the primary concern is that the BCS is, and is being marketed as, a direct competitor to Boeing's 737 family of aircraft, as well as the Airbus 318, 319, and 320 series, regardless of classification.

¶4. (SBU) Canada responded that the ASU provides a satisfactory process for new aircraft financing for Canada and their current position was to wait and see how the classification process unfolded
Qposition was to wait and see how the classification process unfolded
in October before considering additional actions.

¶5. (SBU) Treasury stressed that the uneven playing field would force the USG to explore a variety of options, including possibly providing domestic countervailing financing to Boeing. This could trigger a contagion effect in which the USG and the Europeans could be forced to become significantly involved in domestic aviation financing and Canada could find itself in a race to the bottom.

¶6. (SBU) Canada responded that it is an experienced player in export credit financing and is not trying to carve out a position of competitive advantage outside of existing international rules. Furthermore, competition in regional jets from Brazil/Embraer has been a key factor guiding Canadian decision making (including adherence to the ASU because Brazil was also bound by the agreement). At several points in the exchange, Canadian interlocutors stated that Canada would be strongly opposed to tying its hands on export financing for the BCS if Brazil were not similarly constrained. Canada considers the Embraer 195 to be a competitor to the BCS, especially in the U.S. market. Treasury reasserted its understanding that Bombardier was marketing the

C-Series to U.S. airlines as an alternative to Boeing 737s, and that this was supported by the plane's technical characteristics.

¶7. (SBU) When asked, GOC officials confirmed that since Canada had previously given domestic financing to Bombardier to match Brazil's Embraer financing for Canadian buyers, it would be prepared, without major concern, to do so again if Ex-Im financed Boeing sales to Canada in competing aircraft.

¶8. (SBU) Canada noted that the HMU was precipitated by problems with the disequilibrium between Boeing and Airbus and that a similar disequilibrium exists for Canada vis-`-vis Brazil and Embraer.

¶9. (SBU) Canada expressed concerns that the HMU was unwritten - an opaque agreement among governments that could foster protectionism and anti-competitive behavior and might be susceptible to anti-trust actions. Treasury responded that the spirit of the HMU was to foster a more competitive environment among developed economies by requiring market financing, in accordance with the principles of the ASU preamble. While a legal regime would be optimal it was not possible given the EU's regulatory considerations. Furthermore, despite its unwritten status, the obligations were clearly understood by participants and the HMU has been in operation for over 25 years. Although Canada questioned how it was possible to uphold the spirit of the ASU by going outside of it. Treasury offered a clarification that the HMU did not contradict the ASU and was fully in line with it, including its "Purpose" preamble.

¶10. (SBU) Canada asked a number of follow-up questions:
-- Was there was any pressure from U.S. airlines to retain foreign export credit? Treasury responded that the USG's concern was competition in aircraft financing, not airline operations.
-- Does any new U.S. legislative action have to be taken in order to authorize domestic Ex-Im financing? Treasury responded in the negative. A legal structure already exists to allow immediate action.
-- Are Boeing and Airbus engaged in self-financing activities? Treasury affirmed that this was probably the case. Canada noted that the larger U.S. producers have more self-financing options than does Bombardier.
-- What is the US content in the BCS? Estimates around the table suggested that American content exceeds 60 percent.

¶11. (SBU) The Canadians were asked to outline the nature of the relationship between EDC and GOC and also the procedures for financing. They responded that EDC was an arm's-length Crown Corporation but that the GOC would occasionally consult regarding particular transactions. This point was clarified during the subsequent meeting with EDC where it was revealed that on Corporate Account transactions (source of Bombardier financing), EDC operates with a great deal of autonomy. There is also a "Canada Account" where high-risk projects of a national interest may be funded. GOC provides funds and decision-making for Canada Account transactions and EDC operates as a conduit.

Concluding Messages

¶12. (SBU) Comment: Canadian participants in the inter-ministerial meeting seemed divided between those willing to consider broader economic and foreign policy interests and those narrowly-focused on Bombardier's interests. End comment.
QBombardier's interests. End comment.

¶13. (SBU) Treasury underscored the importance of acting quickly because of aggressive Bombardier sales campaigns unrolling in the U.S. If Bombardier were promising to secure EDC financing , GOC might find itself in the position of having to either support or repudiate these offers before having carefully considered the policy issue. Similarly, once USG interventions were set in motion in response to Canadian financing, it would be very difficult to return to the status quo because aggressive manufacturers might capture the process. To this, a Finance official responded, "Message received." Canada proposed to continue a dialogue on the issue with U.S., while Treasury emphasized that such a dialogue should lead to a fruitful conclusion.

¶14. (SBU) A number of the Canadian officials stated that any arrangement that involved denying access to export credits would be

a "non-starter," especially in the context of a global credit crisis. One official attempted to frame the issue from the Canadian perspective during a period when governments around the world were taking extraordinary steps to save domestic economies and opening up new sources of credit. He opined that the Minister of Finance would "go ballistic" if they told him that the US was asking Canada to stop making lawful interventions in the aviation credit market at a time when the US is "intervening everywhere else to Canada's detriment". (Comment: Canada has been particularly hard hit recently by Buy American provisions for sub-federal spending, Black Liquor credits and softwood disputes in the forest sector, and Country of Origin Labeling in the meat sector. In addition, the large domestic financing programs in the U.S. in response to the recession are seen by Canada as in some cases providing effective subsidization to U.S. domestic industries. End comment)

¶14. (SBU) Some of the Canadians present expressed a preference for 'tweaking' the ASU rather than adopt the HMU in order to find an acceptable solution. While there seemed to be good will on both sides, Canada expected that other aircraft-producing states would have to be brought to the table before the issue was resolvable.

Meeting with Export Development Canada

¶15. (SBU) Similar to earlier presentation to the GOC inter-ministerial group, Treasury set out concerns regarding BCS export credits in the U.S. market. Canada was encouraged to let aircraft compete on their own merits in a competitive environment.

¶16. (SBU) EDC made assurances that no commitments had been made to Bombardier regarding C-Series financing and none will be made until the aircraft is classified. However, a comfort letter has been sent to a potential BCS buyer outlining an ASU-compliant financing process in general terms. After classification, EDC will look at potential sales on a case-by-case basis using current risk

assessment and transaction evaluation tools. EDC noted that the ASU provides certainty of credit but not its price.

¶17. (SBU) When asked, EDC said it did not have an opinion regarding the possibility of Ex-Im financing for competing Boeing aircraft into Canada. EDC confirmed that it had supplied funds to Bombardier for aircraft other than the BCS to counter Embraer sales in Canada.

¶18. (SBU) EDC asked whether potential U.S. domestic financing for Boeing would match EDC financing for Bombardier. Treasury affirmed that this would likely be the case.

¶19. (SBU) EDC echoed GoC concerns about Canada's vulnerability if Brazil were not similarly bound by HMU and the plausibility of Embraer 195 as a substitute for BCS. Treasury responded that in the Southwest Airlines case, the airline was looking to replace 737s, not regional jets. Treasury made that point that there would inevitably be overlaps at the margins between Category 1 and Category 2 aircraft- breaking points would be contentious but that the BCS's main competitors were Category 1 aircraft.

¶20. (SBU) The meeting concluded with EDC speculation on future prospects for Bombardier. In the past, Bombardier had received EDC financing for around 40 percent of its sales but now it is up around
Qfinancing for around 40 percent of its sales but now it is up around 75 percent. EDC estimated that the financial strength of Bombardier was not sufficient for them to finance C-Series purchases on their own. Also, Bombardier's business jet business would soon be eclipsed by the C-Series - with United States and European Union as key markets.

¶21. (U) Attending the meetings for USG Treasury: Sharon Yuan, Deputy Assistant Secretary, Trade and Investment; and Steve Tvardek, Director, Trade Finance. Embassy Ottawa: Eric Benjaminson, Minister Counselor for Economic Affairs; Stephan Wasylko, Minister Counselor for Commercial Affairs and Laura Dawson, Senior Economic Specialist.

¶22. (U) Attending for GOC Finance: Jim Haley, General Director, International Trade and Finance; Lise Carrihre, Senior Chief, International Trade and Finance; John Layton, Chief, Trade Rules,

International Trade and Finance; and Kim McIntyre, Economist, International Trade and Finance. GOC DFAIT: Ian Burney, Assistant Deputy Minister, International Business Development, Investment and Innovation; Julie Insley, Director, International Trade Portfolio and Strategic Analysis (including international financing); Nadine Mawle, Senior Policy Analyst, International Trade Portfolio and Strategic Analysis; and Peter McLachlan, Commercial Policy Analyst. GOC Privy Council Office: Kathleen Cooper, Policy Analyst, Economic and Regional Development Policy. EDC: Glen Simpson, Senior Advisor, Financing Centre of Expertise and International Relations Team; Taso Georgiou, Director, Aerospace Team; and Caroline Dabrus, Director, Financing Centre of Expertise and International Relations Team.

¶23. (U) This cable was cleared by Treasury DAS Yuan and Director Tvardek.